ROUTING AND RECORD SHEET

SUBJECT: (Optional)
Tax Reform Legislation : Potential Impact on CIA Employees

STAT
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FROM: [redacted]
Legislative Liaison

EXTENSION: [redacted]

NO.

DATE: 19 Nov '85

TO: (Officer designation, room number, and building)	DATE RECEIVED	DATE FORWARDED	OFFICER'S INITIALS	COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)
1. D/OP				Attached are tentative decisions reached by House Ways & Means Committee. See page 6 Para. 3 and page 7 Para 4. Senate will not take up Tax Reform until next year. A tax reform law will likely be enacted next year; the effective dates are unknown.
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FOR IMMEDIATE RELEASE
THURSDAY, NOVEMBER 14, 1985

PRESS RELEASE #27-A
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
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THE HONORABLE DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES COMMITTEE ACTION TAKEN ON WEDNESDAY, NOVEMBER 6, 1985, ON COMPREHENSIVE TAX REFORM

The Honorable Dan Rostenkowski (D., Ill.), Chairman, Committee on Ways and Means, U.S. House of Representatives, announced initial Committee action taken on Wednesday, November 6, 1985, on the pension and deferred compensation provisions of the tax reform proposal currently under consideration. The Committee emphasized that these decisions are tentative and may be revisited at any time.

The provisions initially agreed to by the Committee are as follows:

I. Individual Retirement Accounts

A. Spousal IRAs: Present law provides that an individual may exclude from taxable income amounts contributed to an Individual Retirement Account (IRA) up to the lesser of earned income or $2,000 each year. A married couple who files a joint return for the year is entitled to a deduction of $2,250 if one spouse has earned income of at least $2,250 and the other spouse has no compensation for the year. If both spouses have earned income for the year, then the IRA deduction for each spouse is limited to earned income. For example, a spouse, whose only earned income for a year is $50 from jury duty, is entitled to an IRA deduction of only $50, rather than at least a $250 spousal IRA contribution.

The Committee agreed to provide that the total IRA deduction of a married couple could not be less than $2,250, as long as the total earned income of the couple is at least $2,250. Thus, the fact that one spouse had earnings of less than $250 would not limit the availability of the full spousal IRA deduction.

B. Additional income tax on early withdrawals: Under present law, amounts withdrawn from an IRA before the beneficiary dies, becomes disabled, or attains age 59-1/2 are subject to an additional 10-percent income tax.

The Committee agreed to increase the tax on early withdrawals from 10 to 15 percent. The Committee agreed to provide that the tax would be waived for any distribution that is part of a scheduled series of substantially level payments under an annuity for the life of the IRA owner (or the joint lives of the owner and the owner's beneficiary).

II. Qualified Cash or Deferred Arrangements (Section 401(k) Plans)

Present law provides that employees of an employer who has established a qualified cash or deferred arrangement (a section 401(k) plan) may elect to defer taxation on compensation contributed to a qualified profit-sharing or stock-bonus plan. The employer may make contributions to the 401(k) plan, including "matching" contributions conditioned on the elective deferrals of the employees.

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A. Limit on elective deferrals: Current law limits the sum of employer contributions plus elective deferrals on behalf of any employee under a 401(k) plan to the lesser of $30,000 or 25 percent of compensation. The Committee agreed to provide a separate dollar limit of $7,000 on elective deferrals. The Committee also agreed to provide that, as under present law, an employer may make qualified nonelective and matching contributions for any employee; however, the limit on the total amount allocated to any employee each year would be lowered from $30,000 to $25,000. (See discussion of defined contribution plan limits, page 8.)

B. Coordination with IRA contributions: The Committee agreed to reduce an individual's IRA deduction limit by one dollar for each dollar the individual elects to contribute to a 401(k) plan. For example, an individual who contributed $1,500 to a 401(k) plan would be permitted an IRA deduction of $500. The additional $250 spousal IRA deduction would not be reduced by elective 401(k) plan contributions.

C. Nondiscrimination requirement: Under current law, elective deferrals under a 401(k) plan must meet a special nondiscrimination rule. Generally, the actual deferral percentage (the average of deferrals as a percent of compensation) for the highest paid one-third of eligible employees may not exceed 150 percent of the actual deferral percentage of the lowest paid two-thirds of eligible employees. Alternatively, the actual deferral percentage of the top one-third may not exceed the lesser of 250 percent of the actual deferral percent of the lowest two-thirds of employees, or the actual deferral percentage of the lowest two-thirds of employees plus three percentage points.

The Committee agreed to revise the nondiscrimination test for employees' elective deferrals to a 401(k) plan. Under the agreement, the deferral percentage by an employer's highly compensated employees may not exceed 125 percent of the deferral percentage of eligible nonhighly compensated employees. Alternatively, the deferral percentage of an employer's highly compensated employees could not exceed the lesser of 200 percent of the deferral percentage of the nonhighly compensated employees, or the actual deferral percentage of the nonhighly compensated employees plus two percentage points.

Under the agreement, an employee would be treated as highly compensated for a plan year if during the current plan year or either of the two preceding plan years he or she was:

1. a 5-percent owner of the employer;
2. one of the 10 employees owning the largest interest in the employer who have compensation in excess of the limit on annual additions under a defined contribution plan ($25,000 for 1986 under the Committee agreement);
3. an employee earning more than $50,000; or
4. one of the top 10 percent of employees by pay, excluding (a) employees who earn less than $20,000, and (b) employees who earn less than $35,000 and are not among the top 5 percent by compensation.

The Committee agreed to provide a special rule for determining those employees who would be considered highly compensated in the current plan year because they have more than $50,000 of compensation, or are in the top 10 percent of employees by compensation. A special rule also will be provided for family members of the top 10 employees by compensation, if such family members participate in the 401(k) plan.

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D. Withdrawal and other restrictions: Under present law, a participant in a qualified 401(k) plan is not permitted to withdraw elective deferrals (or earnings on such deferrals) before age 59-1/2, death or disability, separation from service, retirement, or the occurrence of a hardship.

The Committee agreed to continue to permit "hardship" withdrawals to the extent of an employee's elective contributions, and to permit withdrawals from a qualified cash or deferred arrangement on account of plan termination.

Under the agreement, withdrawals from a cash or deferred arrangement prior to age 59-1/2, death, or disability would be subject to the 15-percent additional income tax on early withdrawals. (See discussion of withdrawals before age 59-1/2, page 6.)

The Committee also agreed that an employer could not condition, either directly or indirectly (other than through matching contributions), contributions and benefits under any plan upon an employee's elective deferral. In addition, employees could not be required to complete more than one year of service in order to be eligible to make elective deferrals.

The Committee agreed that elective deferrals and qualifying employer matching contributions to a 401(k) plan established by an employer would be permitted in years in which the employer does not have current or accumulated profits. Qualifying employer matching contributions meet the vesting, distribution, and other restrictions of Internal Revenue Code section 401(k).

E. Employees of tax-exempt and public employers: The Committee agreed to clarify current law that tax-exempt and public employers may not establish 401(k) plans. The Committee also agreed to grandfather 401(k) plans maintained by State and local governments and tax-exempt organizations for employers who have adopted a plan and received a favorable determination letter by November 6, 1985. Elective deferrals under grandfathered plans would be coordinated with elective deferrals under 403(b) tax-sheltered annuities and section 457 plans.

F. Effective date: 401(k) plans would have to comply in operation with the agreement in plan years beginning after December 31, 1985. Collectively bargained plans would have to comply in operation with the agreement in plan years beginning after the termination of the collective bargaining agreement. Amendments to the plan document would not be required until plan years beginning on or after January 1, 1988.

III. Nondiscrimination Requirements for Employer Matching Contributions

Under present law, if an employer contribution under a qualified plan is conditioned on an employee's contribution, the employer matching contribution (adjusted, in an integrated plan, for certain social security benefits) must be nondiscriminatory.

The Committee agreed to provide that voluntary employee contributions and qualifying employer matching contributions, as a percentage of compensation for highly compensated employees, may not exceed 125 percent of the average of such contributions as a percent of compensation for the nonhighly compensated employees. Alternatively, the average percentage for the highly compensated employees could not exceed 200 percent of the average percentage for the nonhighly compensated employees, or the average percentage for the nonhighly compensated employees plus two percentage points, if less.

The average of nonqualifying employer matching contributions as a percent of compensation for the employer's highly compensated

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employees could not exceed 110 percent of the average of non-qualifying employer contributions as a percent of compensation for the nonhighly compensated employees. Alternatively, the average percentage for the highly compensated employees may not exceed the lesser of 150 percent of the average percentage of the nonhighly compensated employees, or the average percentage of the nonhighly compensated employees plus one percentage point.

If the employer matching contributions are tied to elective contributions under a qualified cash or deferred arrangement, then these tests would be applied by aggregating employer matching contributions and elective deferrals.

The Committee agreed to provide that contributions to highly compensated employees in excess of the amount permitted under the matching contribution rules would be deductible to the employer, but would be subject to a 10-percent excise tax, unless the excess, plus earnings, are distributed in a timely manner.

IV. Unfunded Deferred Compensation Arrangements of State and Local Governments and Tax-Exempt Employers (Section 457 Plans)

A. Eligible plans: Under an eligible unfunded deferred compensation plan maintained by a State or local government or rural electric cooperative, an employee may elect annual deferrals equal to the lesser of $7,500 or 33-1/3 percent of compensation (net of the deferral). The participant is taxed on the deferred amounts, plus income earned on the amounts, when they are distributed or otherwise made available.

The Committee agreed to apply the rules governing eligible unfunded deferred compensation plans of State and local governments to unfunded deferred compensation plans for employees of tax-exempt employers.

B. Required distributions: The Committee agreed to modify the rules governing distributions from eligible section 457 plans by providing that distributions would be required to satisfy a payout schedule under which benefits projected to be paid over the lifetime of the participant are at least 66-2/3 percent of the total benefits payable with respect to the participant. In the case of benefits payable over a period of more than one year, distributions must be paid on a substantially nonincreasing basis. Also, the agreement provides that, after the death of the employee, payment of benefits to the employee's beneficiary must commence within one year after the employee's death. Under the agreement, benefits would not be treated as made available merely because the employee is allowed to elect a lump sum payable within 60 days after the election. The rule applies only if the employee's total deferred benefit does not exceed $3,500, and if the employee is no longer entitled to elect deferrals under the plan.

Certain tax-free rollovers between eligible unfunded deferred compensation plans would be permitted.

C. Effective date: Eligible plans would have to comply in operation with the agreement for taxable years beginning after December 31, 1985. Plan amendments reflecting the agreement would not be required until plan years beginning on or after January 1, 1988.

V. Deferred Annuity Contracts

Present law provides that income earned under a deferred annuity contract is not taxed currently, but is taxed when paid to the policyholder. Amounts distributed before the policyholder attains age 59-1/2 are subject to an additional income tax equal to 5 percent of the amount included in income. The penalty does

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not apply if the distribution is one of a series of periodic payments lasting at least 60 months, or is made for certain other purposes.

The Committee agreed to provide that a nonindividual owner of a deferred annuity contract would include in income any increase in the cash surrender value of the deferred annuity contract over the contract's basis during the taxable year. The owner of a deferred variable annuity contract would be treated as owning a pro-rata share of the assets and income of any separate account underlying the variable contract. As a result, the owner would not be taxed on the unrealized appreciation of assets underlying a variable contract.

The Committee also agreed that the additional income tax on amounts withdrawn from deferred annuity contracts before age 59-1/2 would be conformed to the 15-percent tax on early withdrawals from IRAs and other tax-favored retirement arrangements.

The proposal would be effective for amounts invested in deferred annuity contracts after September 25, 1985.

VI. Minimum Standards for Qualified Plans

A. Nondiscrimination rules:

1. Coverage requirements for qualified plans: To satisfy the coverage rules of current law, a qualified plan generally must meet either a percentage test, or a "fair cross section" test. A plan meets the percentage test if it benefits at least 70 percent of all employees, or if at least 70 percent of all employees are eligible to participate, and the plan benefits 80 percent of those eligible to participate. A plan meets the fair cross section test if the Secretary of the Treasury determines that it covers a classification of employees that is found not to discriminate in favor of employees who are officers, shareholders, or highly compensated. The Committee agreed to require that the Department of the Treasury conduct a study on the effect of the present law coverage tests, and to make recommendations on the manner in which the coverage rules might be changed. The study and recommendations must be submitted to Congress no later than July 1, 1986.

2. Top heavy plans: Under present law, a plan is top heavy if more than 60 percent of the value of cumulative accrued benefits are provided for key employees. Present law provides no uniform accrual rule for testing whether a plan is top heavy. The Committee agreed to provide that a uniform benefit accrual rule would be applied in testing whether a defined benefit plan is top heavy. Solely for the purpose of determining whether a plan is top heavy or super top heavy, the fractional benefit accrual rule of present law would be applied. The proposal would be effective for plan years beginning after December 31, 1985.

3. Nondiscrimination rule for defined benefit plans: Under present law, a plan meets the nondiscrimination rules of current law if benefits provided under the plan bear a uniform relationship to compensation. For the purpose of testing whether benefits bear a uniform relationship to compensation, the employer-provided share of an employee's social security benefit may be taken into account. Under certain circumstances, employers may take into account an employee's employer-provided social security benefit earned with a prior employer.

The Committee agreed to provide that social security benefits earned with a prior employer could not be considered in testing whether a defined benefit pension plan is considered discriminatory. Qualified plans would be required to comply in operation with this requirement for plan years beginning after December 31, 1985. Plan amendments containing this provision would not be required until plan years beginning on or after January 1, 1988.

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B. Benefit forfeitures: Present law provides that forfeitures in a money-purchase pension plan must be used to reduce future employer contributions or to offset plan administrative expenses. The Committee agreed to provide that forfeitures could be reallocated to the plan's remaining participants. The proposal would be effective for plan years ending after December 31, 1985.

C. Withdrawal of benefits:

1. Uniform minimum distribution rules: Present law provides that the distribution of benefits from a qualified plan must commence no later than April 1 of the calendar year following the calendar year in which the participant attains age 70-1/2, or, in the case of participants who are not 5-percent owners, the taxable year in which the participant retires, if later. A qualified plan that fails to satisfy the minimum distribution rules may be disqualified.

Distributions from an IRA are required to commence no later than April 1 of the calendar year following the calendar year in which the owner attains age 70-1/2. A 50-percent excise tax applies to amounts required to be distributed from an IRA that are not distributed.

The Committee agreed to provide a uniform commencement date for benefits under all qualified plans, IRAs, and tax-sheltered annuities. Distributions would be required to commence no later than April 1 of the calendar year following the calendar year in which the participant attains age 70-1/2.

Under the agreement, the additional sanction for failure to satisfy the minimum distribution rules would be a nondeductible excise tax equal to 50 percent of the excess of the required minimum distribution over the actual distribution.

The proposal would generally apply for distributions made after December 31, 1985. However, employees who are not 5-percent owners and who have attained age 70-1/2 by January 1, 1988, may defer commencement of benefit payments until retirement.

2. Withdrawals before age 59-1/2: Present law provides that an additional income tax is imposed on withdrawals from an IRA before the owner attains age 59-1/2, except for withdrawals made on account of death or disability. A similar tax applies to early withdrawals from qualified plans with respect to 5-percent owners of the employer.

The Committee agreed to conform the early withdrawal rules for qualified plans to the rules for IRAs. Thus, a 15-percent additional income tax would apply to withdrawals from a qualified plan, qualified annuity, tax-sheltered annuity, or IRA, before death, disability, or attainment of age 59-1/2. An exception to this rule is provided for any distribution that is part of a scheduled series of level payments under an annuity for the life of the participant (or the joint lives of the owner and the owner's beneficiary). For example, distributions under a lifetime annuity to a 50-year-old participant under a typical "30-years-and-out" retirement agreement would be exempt from the additional 15-percent tax. The agreement would apply for taxable years beginning after December 31, 1985.

3. Lump sum distribution: Under current law, certain lump sum distributions received under a qualified plan may qualify for special 10-year forward income averaging treatment. In addition, a participant may elect to treat the pre-1974 portion of any lump sum distribution as long-term capital gains.

The Committee agreed to repeal forward averaging with respect to lump sum distributions before age 59-1/2. Under the agreement, individuals who have attained age 59-1/2 could make a one-time

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election to claim forward averaging treatment with respect to a lump sum received from a qualified plan. The averaging period would be reduced from 10 years to 5 years. In addition, the Committee agreed to repeal the elective capital gains treatment for the pre-1974 portion of lump sum distributions.

Generally, the availability of 5-year forward averaging for individuals who have attained age 59-1/2, and the repeal of 10-year forward averaging and capital gains treatment for all other individuals would be effective for distributions received after December 31, 1985. The Committee agreed to provide a transition rule under which individuals who have attained age 55 as of January 1, 1987, would be able to elect that the repeal of 10-year averaging and capital gains be phased in over a 6-year period. Distributions for which qualifying individuals elect phased-out 10-year forward averaging or capital gains treatment after December 31, 1985, would be subject to the marginal rates of current law.

4. Basis recovery: The Committee agreed to modify the treatment of distributions from plans in which there are after-tax employee contributions. Under present law, distributions prior to the annuity starting date are treated as being made first out of nontaxable employee contributions, and then out of taxable amounts (employer contributions and income). Distributions after the annuity starting date are generally treated as part a payment of income, and part a recovery of employee contributions. Under a special rule, if an individual will receive all employee contributions within the first three years after the annuity starting date, then all distributions are considered a return of employee contributions until the individual's basis has been recovered.

The Committee agreed to reverse the ordering rules with respect to distributions before the annuity starting date; that is, distributions would be treated as being made first out of taxable amounts (employer contributions plus income) and then out of nontaxable employee contributions. This proposal would be generally effective for distributions made after December 31, 1985, but would not apply to benefits accrued prior to January 1, 1986.

The Committee also agreed to repeal the special 3-year basis recovery rule, so that each distribution would be treated as part a payment of income, and part a recovery of basis. The proposal would not apply to any amount received as an annuity, if the annuity starting date (i.e., the first day of the period for which an amount is received as an annuity) is on or before January 1, 1986.

5. Loans under qualified plans: Subject to certain exceptions, a loan to a participant from a qualified plan is treated as a taxable distribution of plan benefits. An exception is provided to the extent that the loan when added to the outstanding balance of all other plan loans, does not exceed the lesser of (a) $50,000, or (b) $10,000 or one-half of the participant's accrued benefit. The exception applies only if the terms of the loan stipulate repayment within five years, or within a reasonable period if the loan is used to acquire or improve a personal residence of the participant or family member.

The Committee agreed to modify the provisions of current law in a number of respects. First, the $50,000 limit of current law would be reduced by the highest outstanding loan balance of the prior 12 months. Second, the agreement would provide an exception to the five-year repayment rule only for loans applied to the first-time purchase of the participant's principal residence. Under the agreement, level amortization of a loan over the permissible repayment period would be required. The Committee also agreed to provide a deferral of the deduction for interest paid by employees on loans secured by elective deferrals from a

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401(k) plan or tax-sheltered annuity (403(b) plan), and also by key employees on loans from a qualified plan. The deferral would be accomplished by denying a deduction for interest, but increasing the participant's basis under the plan by the amount of non-deductible interest paid. The agreement would be effective for amounts received as a loan after December 31, 1985.

VII. Tax Deferral Under Qualified Plans

A. Overall limits on contributions and benefits:

1. Defined contribution plans: Effective for years beginning after December 31, 1985, the Committee agreed to reduce the dollar limit on annual additions to a defined contribution plan from $30,000 to $25,000 and treat all employee contributions as annual additions.

2. Defined benefit plans: The Committee agreed to reduce the dollar limit on the annual benefit payable under a defined benefit plan from $90,000 to $77,000 and to reduce the dollar limit proportionately for participants with less than 10 years of participation. The present $200,000 limit on compensation taken into account under top heavy plans would be reduced to reflect the changes in the dollar limits. The agreement would be effective for years beginning after December 31, 1985.

As under present law, the $77,000 limit would be actuarially reduced for benefits commencing prior to age 62, but under the Committee agreement, the dollar limit applicable to benefits commencing at or after age 55 generally would not be reduced to an amount less than $65,000 (for police and firefighters, $50,000, regardless of age). In addition, the dollar limit on benefits payable to airline pilots would be reduced only if benefits commence prior to age 60.

3. Cost-of-living adjustments: Beginning in 1988, the Committee agreement would index the defined benefit plan dollar limit to reflect post-1986 cost-of-living increases. No adjustments would be made to the defined contribution plan limit until the limit equals 25 percent of the defined benefit plan limit. Thereafter, the defined contribution plan limit would be increased to the extent necessary to maintain the limit equal to 25 percent of the defined benefit plan limit.

The Committee also agreed to permit employees to make additional contributions to a qualified cost-of-living account under a pension plan, to provide post-retirement cost-of-living increases.

4. Combined plan limit: Under present law, a combined plan limit applies to an individual who participates in both a defined contribution plan and a defined benefit pension plan of the same employer. The Committee agreement retains the combined plan limit.

In addition, effective for distributions made after December 31, 1985, the Committee agreed to impose a 15-percent excise tax on aggregate annual distributions from all tax-favored retirement arrangements in excess of the greater of $112,500 or 1.25 times the defined benefit plan dollar limit.

B. Deduction for contributions to qualified plans:

1. Profit-sharing and stock-bonus plans: Under present law, employer contributions to a profit-sharing or stock-bonus plan are deductible in the year paid, up to 15 percent of aggregate compensation. If the employer's contribution for a particular year is lower than the deduction limit, the unused limit may be carried over and used in later years.

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Under the Committee agreement, employer contributions to a profit-sharing or stock-bonus plan would be deductible in the year paid, to the extent that the contributions, when added to the employer's share of social security taxes taken into account under the plan (if any), did not exceed 15 percent of aggregate compensation.

In addition, the Committee agreement would repeal the limit carryforward for all profit-sharing and stock-bonus plans.

These provisions generally would be effective for taxable years beginning after December 31, 1985.

2. Combination of pension and other plans: Under present law, if an employer maintains a pension plan (either a defined benefit or money-purchase plan) and either a profit-sharing or stock-bonus plan for the same employee, then the employer's deduction for contributions for that year is generally limited to the greater of (a) the amount needed to satisfy the minimum funding requirements of the pension plan, or (b) 25 percent of the aggregate compensation of covered employees. This limit does not apply when an employee participates in both a defined benefit and money-purchase pension plan of the same employer.

Under the Committee agreement, effective for taxable years beginning after December 31, 1985, if an employee participates in both a defined benefit and money-purchase pension plan of the same employer, then the employer's deduction generally would be limited to the greater of (a) the amount needed to satisfy the minimum funding requirements of the defined benefit pension plan, or (b) 25 percent of the aggregate compensation of covered employees.

3. Nondeductible contributions: Under present law, employer contributions in excess of the deduction limit may be carried over and deducted in later years. Effective for taxable years beginning after December 31, 1985, the Committee agreed to impose a 15-percent annual, nondeductible, excise tax on employer contributions in excess of the deductible limits until the excess is eliminated.

C. Asset reversions under qualified plans: Under present law, assets remaining in a qualified defined benefit pension plan generally may be paid to the employer after plan benefits accrued to the date of plan termination have been provided. Assets reverted to an employer are includible in the employer's gross income.

Effective for assets reverting to an employer pursuant to a plan termination occurring after December 31, 1985, the Committee agreed to impose a nondeductible excise tax equal to 10 percent of the amount reverted to the employer.

VIII. Provisions Relating to Tax-Sheltered Annuity Programs

A. Overall limits on contributions: Under present law, in the case of a tax-sheltered annuity, special one-time elections increase the overall limit on contributions under a defined contribution plan to permit contributions in excess of the usual limits.

The Committee agreed to retain the special catch-up elections of present law.

B. Nondiscrimination requirements: Under present law, a qualified plan must meet requirements as to coverage and as to contributions and benefits provided under the plan, which ensure that the plan does not discriminate in favor of employees who are officers, shareholders, or highly compensated. A tax-sheltered annuity program maintained by a tax-exempt charitable organization

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or certain educational institutions is not required to meet these nondiscrimination rules.

The Committee agreed to extend certain nondiscrimination rules to tax-sheltered annuity programs other than those maintained by churches. With respect to employer (i.e., nonelective) contributions to tax-sheltered annuity programs, the Committee agreed to apply the general nondiscrimination tests of present law. The Committee agreed to direct the Secretary of the Treasury to take into account the special circumstances of tax-exempt organizations (including the compressed salary ranges of employees) in applying these nondiscrimination rules.

With respect to elective contributions to tax-sheltered annuity programs (other than programs maintained by churches), the Committee agreed to require that the employer make elective contributions available to all employees without a minimum contribution requirement.

These proposals would apply for plan years beginning after December 31, 1985.

C. Limits on elective contributions: Effective for plan years beginning after December 31, 1985, the Committee agreed to apply the $7,000 section 401(k) dollar limit on elective deferrals to elective deferrals made under tax-sheltered annuity programs. In addition, the Committee agreed to coordinate such elective contributions with an employee's IRA contributions in the same manner as section 401(k) elective deferrals are coordinated with IRA contributions.

D. Withdrawal rules:

1. Withdrawal restrictions: Under present law, withdrawals under a tax-sheltered annuity invested in a custodial account may not commence prior to the time an employee attains age 59-1/2, dies, or becomes disabled, separates from service, or encounters financial hardship. Other tax-sheltered annuities are not subject to these withdrawal restrictions.

The Committee agreed to apply modified withdrawal restrictions to all tax-sheltered annuities. Under the Committee agreement, withdrawals under any tax-sheltered annuity generally may not commence prior to the time an employee attains age 59-1/2, dies, becomes disabled, or separates from service. However, the Committee agreed to permit hardship withdrawals of elective contributions.

In general, these restrictions would apply for taxable years beginning after December 31, 1985. However, the new restrictions would not apply to a tax-sheltered annuity with respect to which no additional contributions were made after December 31, 1985.

2. Additional income tax on early withdrawals: Under present law, a 10-percent additional income tax is imposed on certain early withdrawals from qualified plans with respect to 5-percent owners who have not attained age 59-1/2, unless the early withdrawal is made on account of the employee's disability or death. Distributions from tax-sheltered annuities are not subject to the 10-percent additional income tax on early distributions.

Effective for distributions made after December 31, 1985, the Committee agreed to impose a 15-percent additional income tax on amounts withdrawn by an employee from a tax-sheltered annuity prior to attainment of age 59-1/2, unless made on account of the employee's death or disability. As for distributions from other tax favored retirement savings arrangements, an exception is provided for distributions under a qualified life annuity.

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